Mock Exam

2
## PRACTICE EXAM LEVEL 1 2016

### Mock Exam 2—Questions

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Questions 1–18 Ethical and Professional Standards

1. Which of the following is the most accurate statement regarding candidates in the CFA Program according to the CFA Institute Standards?

   A. Candidates do not need to comply with the CFA Institute Standards until they are awarded the CFA charter.
   B. Candidates can claim only partial CFA designation if they have passed one or more levels of the examinations.
   C. To be a candidate a person must have both successfully registered for the CFA Program and enrolled for one of the CFA examinations.

   Answer: C

   LOS 2a

   The CFA Institute Standards of Professional Conduct apply to both members and candidates, so choice A is not correct. Partial designation is not permitted, so choice B is not correct. Choice C is a correct statement.

2. Karren Black, CFA, is a portfolio manager. She has just taken over a sizeable portfolio of securities that a client has transferred from another portfolio manager. The portfolio has a large holding in a small company, Micro Engineering, which is an illiquid stock. After doing research into the prospects of Micro Engineering, Black decides to sell the holding in the company. Her sell orders push down the price of the stock. Black:

   A. Has not violated Standard II(B): Market Manipulation.
   B. Has violated Standard II(B): Market Manipulation, since she distorted the share price of Micro Engineering.
   C. Has violated Standard II(B): Market Manipulation, since she should have made every effort to spread the sale orders across a number of brokers to reduce the price impact of the trades.

   Answer: A

   LOS 2b

   Black had no intention of misleading the market, so she did not violate Standard II(B); therefore, the correct answer is A.
3. Isabella Maserati, CFA, an analyst, is writing a report on the Bermuda Railtrack Corporation (BRC). She is a friend of the wife of the chief executive officer (CEO) of BRC, and when chatting about the report she is writing, the CEO’s wife says that her husband told her BRC is intending to cut the dividend paid to shareholders in BRC. An announcement will be made the following week and it is expected to be badly received by investors. Maserati quickly finishes her report with a “sell” recommendation based on the anticipated dividend cut.

Based on the CFA Institute Standards:

A. Maserati should not use the information from the CEO’s wife because it is material and nonpublic information.
B. Maserati should immediately disseminate the information to institutional clients and individual investors on a fair basis.
C. The information that BRC is likely to cut the dividend is unconfirmed therefore Maserati is free to use the information to internally justify her sell recommendation but should not mention in the report that the dividend will be cut.

Answer: A

LOS 2b

Maserati should be aware that the information is material and nonpublic and therefore not write the report, which may cause others to act on the information.

4. Robert Shoemaker, CFA, is an automotive analyst in the brokerage arm of an investment bank. He changes his recommendation on Bayer Motors to a “sell” after looking at the unofficial computer-generated model on the Internet of the new two-door sports model to be launched next year. He states that the new model is unattractive and therefore forecasts that sales growth will slow down. Shoemaker’s approach:

A. Violates the insider trading rules.
B. Reflects the misappropriation theory.
C. Reflects lack of distinction between facts and opinions.

Answer: C

LOS 2b

According to Standard V(B), Shoemaker should clearly differentiate between facts and opinions.
5. The corporate finance department of an investment bank recently obtained a mandate to underwrite a bond offering from Endiron Corp. The director of the corporate finance department issues a circular requesting that all research reports about Endiron should carry a favorable recommendation. Charlotte van Nistelroyen, CFA, the equity analyst covering Endiron is about to write a “sell” recommendation as a result of Endiron’s current production capacity constraints. According to the CFA Institute Standards:

   A. The investment banking company should put Endiron on a restricted list, and only disseminate factual information.
   B. Van Nistelroyen has professional and commercial duties to her employer and therefore should change the recommendation to a “buy.”
   C. Van Nistelroyen, as an equity analyst, is free to write the research report without any pressure since it is a bond issue not an equity issue.

**Answer: A**

**LOS 2c**

A firewall should be used to separate the corporate finance and research departments and this would include putting stocks on a restricted list if the corporate finance department is doing an issue for the company.

6. Which of the following parties are *least likely* to be affected by the Global Investment Performance Standards (GIPS®)?

   A. Regulatory authorities
   B. Investment management firms
   C. Prospective clients of investment firms

**Answer: A**

**LOS 3a**

GIPS apply to investment management firms and prospective clients. GIPS compliance is not usually a regulatory requirement.

7. The CFA Institute Code of Ethics specifically addresses all of the following *except:*

   A. Competence.
   B. Supervisory responsibilities.
   C. Integrity of the investment profession.

**Answer: B**

**LOS 1b**

Supervisory responsibilities are addressed in the Standards of Professional Conduct, not the Code of Ethics.

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8. Edward Winsore, CFA, based in California, manages the pension fund of a privately owned company, Brandsohn. The proprietor, Christina Brandsohn, is pleased with the consistent outperformance over the benchmark. She offers Winsore, as a token of gratitude, two tickets to a Broadway show and a weekend in New York, all expenses paid. According to the CFA Institute Standards, Winsore should:

A. Reject the offer.
B. Pay for his travel but is free to accept the offer of accommodation and tickets.
C. Report the offer to his employer and if his employer agrees he is free to accept the offer.

Answer: C

LOS 2b

Winsore will be in compliance with Standard I(B) if he discloses the gift to his employer, and as long as his employer doesn’t object, he can accept the offer.

9. Pauline Krakowsky, CFA, is the marketing director of the high net-worth division of Smoke Investment Advisory Firm. In order to impress the retired chairman and cofounder of the publicly listed Lee Kok Soy Property Development, she requests that the research department of the affiliated brokerage arm of Smoke write a favorable recommendation for the listed company. Krakowsky hopes to win discretionary investment management business from Lee Kok Soy. Krakowsky’s request is:

A. In violation of the CFA Institute Standards.
B. A legitimate business practice and not inconsistent with the CFA Institute Standards.
C. Not in violation of the CFA Institute Standards if the listed company operates in a country with less strict regulations than the CFA Institute Standards.

Answer: A

LOS 2b

The request is in violation of Standard I(B) as the research department is being asked to compromise the independence and objectivity of an investment recommendation.